ORLANDO

KEYSPAN ENERGY DELIVERY NEW ENGLAND

Direct Testimony of Justin C. Orlando

Exhibit KEDNE/JCO-1

D.T.E. 03-40

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Justin C. Orlando. My business address is One MetroTech Center, Brooklyn, New York 11201-3851.

Q. By whom are you employed and in what capacity?

A. I am the Vice President of Human Resources for KeySpan Corporate Services LLC (the "Service Company"). In this position, I implement strategy, policies and procedures for the various business units operated by KeySpan Corporation ("KeySpan") relating to employee compensation, benefits, and payroll services. I am also responsible for KeySpan's technical and customer-service training programs and corporate diversity programs. My responsibilities include managing human-resource activities for Boston Gas Company d/b/a KeySpan Energy Delivery New England ("Boston Gas" or the "Company").

Q. Please describe your educational background and business experience

A. I received a Bachelor of Arts degree in Economics from City University of New York in 1976. In 1984, I received a Master of Finance and Business Administration from Wagner College in New York. I have also attended advanced training sessions and seminars sponsored by Harvard University and IBM. From 1977 through 1997, I was employed by Brooklyn Union Gas Company in a number of positions serving last as General Manager of Human

Resources. In 1997, I joined the MacManus Group, an international advertising firm, as Senior Vice President and Director of Human Resource Services, where I had responsibility for compensation, benefits, human-resource policy and international relocations to organizations in over 74 countries. In 1998, I joined KeySpan Corporation as Vice President, Compensation and Benefits.

Q. Have you previously testified before the Massachusetts Department of Telecommunications and Energy?

A. I have not had the opportunity to testify before the Department of Telecommunications and Energy (the "Department") prior to my participation in this case. I have previously testified before the New York Public Service Commission on behalf of Brooklyn Union Gas Company on employee compensation matters.

Q. What is the purpose of your testimony?

A. I am testifying on behalf of Boston Gas on issues relating to employee wages, salaries and benefits. Specifically, my testimony provides support for the Company's post-test year adjustments related to: (1) union and non-union wage and salary increases; (2) union and non-union incentive compensation; and (3) increases for healthcare premiums and dental coverage. In addition, my testimony reviews the comparative analyses performed to establish the reasonableness of the Company's total compensation levels

Q. Please describe the exhibits attached to your testimony.

A. The following exhibits are discussed in my testimony:

KEDNE/JCO-2	Schedule of Union Payroll Increases
KEDNE/JCO-3	Management Commitment for Non-Union Payroll Increases
KEDNE/JCO-4	Historical Correlation of Non-Union and Union Increases
KEDNE/JCO-5	Healthcare Premium Increases
KEDNE/JCO-6	Dental Coverage Increases
KEDNE/JCO-7	2002 Union Employee Salary Survey
KEDNE/JCO-8	Comparison of Union Wage Increases By Percentage
KEDNE/JCO-9	2002 Non-Union Employee Salary Survey
KEDNE/JCO-10	Comparison of Non-Union Merit Increase by Percentage
KEDNE/JCO-11	2002 Non-Union Employee Benefit Plan Comparison
KEDNE/JCO-12	2001 Total Compensation Analysis
KEDNE/JCO-13	Comparison of Total Compensation to Benefit Expense

Q. How is your testimony organized?

A. The remainder of my testimony is organized as follows: Section II discusses the approach used by KeySpan to establish overall employee compensation and reviews the post-test year changes in union and non-union wages and salaries that will take effect on or before April 30, 2004, the midpoint of the rate year. Section II also discusses KeySpan's incentive-compensation plan (the "Incentive Plan") and the approach taken to normalize incentive payments in the test year. Section III reviews the known and measurable increases in healthcare and dental costs in

2003 and describes KeySpan's initiatives to contain those costs. Section IV provides a comparative analysis demonstrating that the Company's total compensation costs are reasonable in comparison to other investor-owned utilities and non-utility companies in the service area within which the Company competes for similarly skilled employees.

II. EMPLOYEE COMPENSATION

Q. What is the approach that KeySpan uses to set overall employee compensation levels?

A. In terms of establishing the appropriate level of employee wages, salaries and benefits, the Company must strike a balance between the need to attract, retain and motivate qualified employees and the obligation to minimize the cost of providing safe and reliable service to its customers. In that regard, it is KeySpan's enterprise-wide objective to provide a total compensation package that is competitive with the median level of the marketplace for both utilities and general industry. For example, KeySpan's policy on base salaries is to compensate employees at the 50^{th} percentile of the geographic region in which the employees work. This approach enables the Company to attract and retain qualified employees, while ensuring that compensation levels are reasonable as compared to industry standards. In order to maintain compensation levels within the median range, KeySpan participates in annual surveys that compile and report compensation data for evaluative and comparison purposes. KeySpan reviews the resulting wage and salary data for benchmark positions in the Northeast, including the Greater Boston and New York metropolitan areas. Information obtained from these surveys is used to establish wage and salary levels and to determine appropriate base-salary increases throughout the organization.

KeySpan uses a similar process to determine employee-benefit levels. KeySpan monitors the marketplace in order to design benefit programs that are both cost effective and attractive to its employees. This process takes into consideration the market level of benefits for both utilities and general industry.

Q. Is employee performance a factor in setting annual wage and salary levels?

A. Yes. KeySpan's philosophy for setting employee wages and salaries is that compensation should be linked directly to performance results through the use of an incentive framework. To accomplish this objective, KeySpan is transitioning its employee-compensation programs in New England to a variable-pay structure under which a greater percentage of an employee's compensation is linked to performance. Also, this means that wages and salaries for both union and non-union employees involve two components, i.e., base pay and incentive pay. I will discuss KeySpan's Incentive Plan in more detail below.

Q. Has the Company committed to payroll increases for union employees that must be taken into account in setting rates in this proceeding?

A. Yes. As discussed in the testimony of Mr. McClellan, the Company has adjusted test-year expense levels to account for payroll increases for union employees, as required by currently effective collective bargaining agreements. These increases are listed by bargaining unit in Exhibit KEDNE/JCO-2 and are also specified in the respective bargaining agreements. As shown in Exhibit KEDNE/JCO-2, wage increases ranging from 3.00 to 3.75 percent took effect during the test year for all eight of the listed bargaining units.

The currently effective collective-bargaining agreements also commit the Company to payroll increases for union personnel in 2003. These increases range from 3.0 percent and 3.75 percent, as listed by bargaining unit in Exhibit KEDNE/JCO-2. For 2004, the Company has collective bargaining agreements with two bargaining units that will receive payroll increases of 3.0 percent prior to the midpoint of the rate year, April 30, 2004.

Q. **Please describe the Company's non-union payroll structure.**

A. The Company's non-union payroll structure consists of base pay and incentive pay. A non-union employee's base pay may grow over time as a result of annual merit increases to base pay, which are awarded to an employee if the employee's performance meets specific criteria. An employee's base pay may also be increased to account for promotions, market adjustments or a change in job responsibilities. As discussed below, incentive compensation (or variable pay) is awarded annually if specific performance targets are met.

Q. **Has the Company committed to payroll increases for non-union employees that must be taken into account in setting rates in this proceeding?**

A. Yes. As discussed in the testimony of Mr. McClellan, the Company has adjusted test-year expense levels to account for payroll increases for non-union employees during 2002, and increases taking effect prior to the midpoint of the rate year

(April 30, 2004). During the test year, Boston Gas non-union employees received an increase of 2.75 percent, and Service Company employees received an increase of 3.75 percent, both effective April 1, 2002. These increases have been annualized for the test year by Mr. McClellan.

In addition, Exhibit KEDNE/JCO-3 presents an express commitment from management that non-union merit (or base pay) increases will become effective October 1, 2003 (for management) and March 1, 2004 (for officers). As stated in Exhibit KEDNE/JCO-3, Boston Gas non-union employees (including those in the Service Company) will receive a merit increase of 2.5 percent of base salary on October 1, 2003 (following a six-month delay from April 1, 2003). New York-based employees will receive a merit increase of 3.5 percent.

However, in terms of the overall payroll increase, Mr. McClellan has adjusted test-year payroll costs by 3.5 percent for Boston Gas employees and 4.5 percent for New York employees. This adjustment accounts for the 1.0 percent increase of 2002 total payroll expense that KeySpan has committed to cover wage and salary increases associated with employee promotions, market-based adjustments and changes in job responsibilities during the year.

Also, as stated in Exhibit KEDNE/JCO-3, increases for corporate officers are scheduled to take effect on or before March 1, 2004 (following a 12-month delay from March 1, 2003). Although KeySpan has made an express commitment to increase the salaries of its corporate officers, the precise amount of the merit increase for officers is determined by the Board of Directors at the time the increase is granted. Therefore, the test-year adjustment made in Mr. McClellan's testimony includes a 3.5 percent merit increase consistent with the Company's historical practice to grant increases to corporate officers that, at a minimum, are equal to management increases, and frequently are up to one half of a percent higher. The Company has included these known and measurable increases to test year non-union salary expense consistent with Department precedent.

Under Department precedent, a demonstration that the Company's management has historically granted non-union increases on an annual basis, and that an historical correlation has existed between union and non-union payroll increases provides support for management's commitment to merit increases. Accordingly, Exhibit KEDNE/JCO-4 shows the historical correlation between union and management increases for an 11-year period ending with 2003. Exhibit KEDNE/JCO-4 also shows a comparison of the non-union and union increases for the Service Company since the merger of KeySpan and Eastern Enterprises. This analysis shows that the Company has consistently increased non-union salaries over the historical periods at levels comparable to the union increases. This analysis, in combination with the express commitment to provide merit increases for management and corporate officers on October 1, 2003 and March 1, 2004, respectively, establishes that these wage increases are known and measurable under Department precedent.

Q. Would you describe how the Incentive Plan operates?

A. Yes. In KeySpan's view, the Incentive Plan is a critical tool in achieving its overriding corporate objective of building long-term value for customers, shareholders and employees. This perspective reflects KeySpan's recognition that the ability to achieve its long-term corporate objectives is linked to employee performance at every level of the organization. Therefore, the Incentive Plan is carefully tailored to motivate all employees to perform in a manner, and to a level, that has a positive effect on the Company's ability to provide safe, reliable and cost-effective service to customers, while also contributing to the Company's earnings objectives. The basic structure of the plan involves: (1) specific performance goals that, if achieved, will be beneficial to customers and shareholders; and (2) financial incentives that are linked to various performance levels.

For example, the goal structure established in the Incentive Plan involves three categories of performance goals: (1) corporate goals; (2) business unit or area-specific goals; and (3) strategic initiative or assessment goals. Specific performance goals are set within each goal category. The employee-driven goals fall into one of the three categories, or may be a combination of one or more of the categories. In 2002, the specific goals for Boston Gas employees included the following: (1) achieving earnings objectives; (2) containing operations and maintenance costs; (3) ensuring customer satisfaction; (4) maintaining or improving safety; and (5) developing workforce diversity. The performance goals for each category are weighted consistent with the priorities of the business unit within which an employee functions. The performance results achieved are dependent upon each employee's efforts within the KeySpan organization.

The Incentive Plan also establishes a pay-out scale for each performance goal. If performance goals or "targets" are met for the annual performance period, employees receive 100 percent of the target pay-out amount. In addition, a minimum acceptable level, or "threshold," is established for each performance goal, as well as a "maximum." For performance at the threshold level, the incentive pay-out is 50 percent of the target-incentive level, and if performance is at or above the maximum, the pay-out is two times the target level. Pay-outs are prorated to the extent that performance falls within this bandwidth.

Each year, the Board of Directors reviews and approves the performance goals and pay-out scale prior to the start of the performance period. At the end of the performance period, the Board of Directors approves the payment of compensation if corporate goals are attained. Incentive payments are made in March for performance in the prior year. Because incentive payments are linked to performance levels, the total amount of incentive compensation paid to employees may differ from the target level on a year-to-year basis. For example, in 2003, the Company paid incentive payments above the target level. However, for ratemaking purposes, the Company has set the expense at the test-year target level. The target level is most representative of what the Company's incentive-compensation expense will be over time.

As noted above, the incentive-compensation plan previously in place for Boston Gas was not comparable to the plan in place for employees within the KeySpan organization. Specifically, the incentive payments available to Boston Gas employees were less than those available to KeySpan employees in New York (on a percentage basis). However, the salaries of Boston Gas employees were closer to the median for the Greater Boston area so that the addition of incentive payments under the KeySpan plan would have caused the Boston Gas salaries to exceed the median for this geographic area. Therefore, KeySpan initiated a three-year transition plan to standardize the Incentive Plan for all KeySpan employees by raising the incentive-percentage opportunities for Boston Gas employees and slowing the pace of their base wage and salary increases. As a result, on an overall basis, wages and salaries for Boston Gas employees will remain consistent with the median for this area.

III. EMPLOYEE BENEFITS

Q. Would you briefly describe the benefit package offered to employees by the Company?

A. The Company provides a number of different benefit plans to non-union, union and retired employees. For active non-union and union employees, the Company offers medical, dental, vacation, holiday, disability and life insurance benefits, as well as a 401K plan and a pension plan. The Company also offers post-retirement medical, dental and life insurance to qualifying employees.

Q. **Has the Company experienced increases in the premiums for health care insurance programs offered to union and non-union employees in 2003?**

A. In 2003, the Company experienced known and measurable increases in the premiums associated with the healthcare-insurance plans in which Boston Gas and Service Company employees participate. Exhibit KEDNE/JCO-5 provides documentation of the 2003 premium increases applicable to the benefit programs offered to the Company's employees. To determine the total increase that the Company will actually incur as a result of employee participation in its available healthcare-insurance programs, the Company analyzed the premium increases by plan and by individual employee and annualized the amounts for ratemaking purposes.

In 2003, KeySpan initiated a self-insurance plan for drug coverage for its New England employees, including Boston Gas, rather than continuing to pay for drug coverage within the monthly premiums for individual and family healthcare plans. KeySpan began implementing the same approach in New York beginning in 2001. KeySpan estimated that it could defray approximately five percent of the incremental cost of including drug coverage in the individual and family healthcare plans offered to employees. Accordingly, to calculate the post-test year adjustment for healthcare premium increases, the Company first identified the 2003 premium for the applicable plans for each individual and family policy, including drug coverage, and then calculated the test-year adjustment using the 2003 premiums without drug coverage, plus 95 percent of the difference between the policy cost with and without drug coverage. The 2003 premiums set forth in Exhibit KEDNE/JCO-5, represent the quoted policy premiums without drug coverage, plus the 95 percent adjustment, unless otherwise noted. The calculation of the test-year expense adjustment is further discussed in the testimony of Mr. McClellan.

Q. Has the Company experienced increases in the costs of dental coverage for union and non-union employees in 2003?

A. In 2003, the Company experienced known and measurable increases in the costs of providing dental coverage to Boston Gas and Service Company employees. For example, in 2002, the actual rates for individual and family coverage were \$25.47 and \$80.73, respectively. In 2003, Delta Dental has established working rates of \$27.51 for an individual, and \$87.20 for family coverage. Exhibit KEDNE/JCO-6 provides documentation of the working rates established by Delta Dental for 2003. To determine the total increase that the Company will actually incur as a result of employee participation in its available dental programs, the Company analyzed the cost increases by plan and by individual employee and annualized the amounts for ratemaking purposes. The calculation of the test-year expense adjustment is discussed in the testimony of Mr. McClellan.

Q. What efforts has KeySpan undertaken to control costs associated with its healthcare and dental benefit programs?

A. KeySpan has implemented a number of changes to control the costs associated with its healthcare and dental benefit programs. These changes include:

- Redesigning all union and non-union healthcare plans to include: increased deductibles, higher office-visit copayments, higher emergency room copayment amounts, higher hospital admission copayments, and increased out-of-pocket maximums;
- Consolidating all retail and mail-order prescription drug coverage under one provider, increasing prescription copayments, establishing a three-tier copayment structure, and implementing a mandatory mail-order feature for maintenance prescription drugs;
- Increasing employee contributions for both healthcare and dental coverage. For, example, non-union employees now pay $203 per month for family coverage and $72 per month for individual coverage as compared to employee contributions of $160 and $55 per month in 2002, and $99 and $35 per month in 2001.
- Capping the Company's liability for annual healthcare premiums relating to union and non-union retirees at $3,375 per retiree and spouse over the age of 65, with retirees paying the full cost of coverage above the caps;
- Eliminating the Company's liability for healthcare coverage after the age of 65 for non-union retirees hired after January 1,1993;
- Eliminating dental coverage after the age of 65 for union and non-union retirees.

Q. How do the increases that the Company will experience in healthcare and dental costs compare to cost increases at the national level?

A. As discussed in the testimony of Mr. McClellan, the Company has adjusted test-year expenses to reflect known and measurable healthcare premium increases on average of 13.21 percent for Boston Gas and 12.10 percent for the Service Company (Exhibit KEDNE/PJM-2, at page 11). These increases are lower than the increases generally experienced in the marketplace, which range from 14 to 17 percent. In addition, costs for dental benefits have increased 4.2 to 8.0 percent nationally, versus the 7.17 percent and 0.5 percent increases that the Company experienced for Boston Gas and Service Company employees, respectively, in 2003. Therefore, the cost increases that the Company will incur on behalf of employees are less than or comparable to the increases generally experienced in the marketplace and are indicative of the strong cost-containment measures implemented by the Company, including providing for increased employee responsibility in these areas.

III. REASONABLENESS OF TOTAL COMPENSATION

Q. Did the Company perform a comparative analysis to demonstrate the reasonableness of its total compensation levels?

A. Yes. As required under Department precedent, the Company has performed various analyses to compare payroll and benefit expense levels in relation to other New England (and Northeast) investor-owned utilities and companies located within its service territory with which it competes for similarly skilled employees. These analyses show that the Company's payroll and employee benefits are set at a level that is consistent with KeySpan's overall business strategy to offer total compensation packages that appropriately balance the need to attract, retain, and motivate qualified employees with the obligation to minimize cost. In addition, these analyses show that the Company's payroll and benefit levels and planned increases compare favorably to other utilities and non-utilities in New England and the Northeast. Each of these analyses is discussed in turn below.

Q. Please review the comparative analyses performed in relation to union payroll increases.

A. The Company has provided two surveys to compare union wage expense levels and payroll increases. First, Exhibit KEDNE/JCO-7 summarizes the results of an American Gas Association ("AGA") survey of participating local distribution companies that compares average hourly wage rates and bonuses paid by participating Northeast utilities to the average hourly rates and bonuses paid to Boston Gas union employees. The results of this survey show that the average hourly rate paid by the Company per position is $24.39, with bonuses of $150, as compared to an average hourly rate of $24.13 paid by other Northeast utilities, with bonuses of $1,900 on average (for utilities that paid bonuses). If compared on the basis of the average hourly wage rate, the Company's union rates are on target with the industry average for the Northeast. If computed on an hourly basis with bonus, the Company's union rates are lower than the average rate for Northeast utilities.

Second, Exhibit KEDNE/JCO-8 provides a comparison of the historical wage increases (on a percentage basis) for union employees for the period 1993 through 2003 for eleven New England utilities. As shown, the Company's contractual wage increase in 2002 of 3.0 percent is within the range of 2.5 to 4.0 percent for other New England utilities. Similarly, in 2003, wage increases for Boston Gas union employees were 3.0 percent, as were the increases for union employees at other Massachusetts gas utilities.

Q. Please review the comparative analyses performed in relation to non-union payroll increases.

A. The Company has provided two surveys to compare salary expense levels and payroll increases for non-union employees.

First, Exhibit KEDNE/JCO-9 summarizes the results of an AGA survey that compares representative and comparable Boston Gas non-union base salaries and total compensation with the salaries and total compensation of Northeast gas companies and of general industry. This exhibit demonstrates that salaries and total compensation for Boston Gas management employees are comparable to those of Northeast utilities and non-utility companies in the greater Boston Area. Exhibit KEDNE/JCO-9 also includes a comparison of salaries and total compensation for New York-based Service Company positions with salaries and total compensation of Northeast gas companies and non utility companies in the New York metropolitan area. As with the salaries for Boston Gas employees, the salaries and total compensation for the Service Company compare favorably both with Northeast gas companies and with general industry.

Second, Exhibit KEDNE/JCO-10 shows a comparison between the Company's merit increases (on a percentage basis) for non-union employees in 2002 and 2003, and those for other utility and non-utility businesses. As shown, the

Company's non-union merit increases in 2003 of 3.5 to 4.5 percent (including 1.0 percent for other compensation adjustments) are consistent with the average increases of other companies and utilities for the same time periods.

Q. Does KeySpan periodically assess how its employee benefit plans compare to other companies?

A. Yes. KeySpan actively monitors and analyzes the benefit packages offered to employees to determine whether overall benefit levels are comparable with other energy companies. On an overall basis, the benefit levels provided to Boston Gas and Service Company employees are consistent with the benefits provided by other energy companies. For example, Exhibit KEDNE/JCO-11 reviews the relative value of the non-union benefit plans for Boston Gas and Service Company employees.

Q. Did the Company also perform a comparative analysis of total compensation for union and non-union employees?

Yes. The Company conducted a survey to compare total compensation, including salaries and wages and benefits for fourteen (14) New England utilities. This survey utilized 2001 data as filed by the respective companies in their annual returns to the public-utility commissions and the Federal Energy Regulatory Commission. This analysis is provided in Exhibit KEDNE/JCO-12. As shown there, the total compensation per Boston Gas employee is $82,729 as compared to the average of $96,285 for the utilities surveyed.

Q. **Describe how the Company's benefits compare as a portion of total compensation to those of other utilities and companies surveyed.**

A. The results of a study performed by the Saratoga Institute are shown in Exhibit KEDNE/JCO-13. For Boston Gas employees, benefit expense represents approximately 20.4 percent of total compensation. This percentage compares favorably to both the regional and industry analysis, which range from 21.2 to 23.5 percent.

Q. **Does this complete your testimony?**

A. Yes.